

Message Text

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11

ACTION EA-14

INFO OCT-01 ADP-00 SCEM-02 AID-20 EB-11 NSC-10 RSC-01

CIEP-02 TRSE-00 SS-15 STR-08 OMB-01 CEA-02 CIAE-00

COME-00 FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06

SIL-01 INT-08 AGR-20 L-03 RSR-01 DODE-00 /157 W

----- 041331

R 090420 Z JUN 73

FM AMEMBASSY PHNOM PENH

TO SECSTATE WASHDC 1614

C O N F I D E N T I A L SECTION 1 OF 2 PHNOM PENH 5682

FOR STATE/ AID

E. O. 11652: GDS

TAGS: EFIN, CB

SUBJECT: CURRENT ECONOMIC PROBLEMS

THE FOLLOWING PAPER IS BEING PRESENTED TODAY TO PRIME MINISTER
IN TAM BY THE AMBASSADOR AND THE ACTING ECONOMIC COUNSELOR.

CURRENT ECONOMIC PROBLEMS

IN JANUARY OF THIS YEAR WE PRESENTED TO THE GOVERNMENT FOR ITS CON-
SIDERATION A PAPER ENTITLED / LES GRANDES DECISIONS ECONOMIQUES DE
1973," A COPY OF WHICH IS ATTACHED. THE PURPOSE OF THAT PAPER
WAS TO CALL THE STANDARD OF LIVING OF THE POPULATION PRIMARILY
THROUGH LIMITING THE INCREASE IN THE MONEY DDPPLY, THE MAJOR
REASON FOR THE HIGH RATE OF INFLATION.

WHILE SOME PROGRESS HAS BEEN MADE, NOTABLY IN REDUCING THE NUMBER
OF MEN PAID BY FANK BELOW 253,000 AND INCREASING PADDY PRICES,
THE ECONOMIC SITUATION HAS DETERIORATED SIGNIFICANTLY SINCE
JANUARY. CONSUMER PRICES HAVE RISEN OVER 30 PERCENT SINCE DE-
CEMBER 1972 AND SUPPLY PROBLEMS HAVE BECOME MORE ACCUTE BECAUSE
OF WIDESPREAD FIGHTING AND INTERDICTION OF LINES OF COMMUNICATION.
THE DETERIORATION HAS BEEN AGGRAVATED BY THE VERY HIGH LEVEL
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OF GOVERNMENT EXPENDITURES NOT COMPENSATED BY AN INCREASE IN TAX COLLECTIONS.

DESPITE THESE UNFAVORABLE FACTORS, THE OBJECTIVE SHOULD CONTINUE TO

BE TO KEEP THE INCREASE IN THE MONEY SUPPLY DOWN TO 25 PERCENT. THIS MUST BE ACCOMPLISHED IN A MANNER THAT WILL NOT AGGRAVATE SOCIAL UNREST. THE MEASURES REQUIRED INCLUDE PRICE ACTIONS, MANAGEMENT OF REALISTIC EXCHANGE RATE, STRINGENT CONTROL OF GOVERNMENT EXPENDITURES, ENERGETIC STEPS TO INCREASE REVENUES, ADJUSTMENTS IN GOVERNMENTAL SALARIES, MAXIMIZATION OF THE SUPPLY OF DOMESTICALLY PRODUCED COMMODITIES SUCH AS RICE AND SUPPRESSION OF SUBSIDIES (EXCEPT IN THE CASE OF IMPORTED RICE).

THE GOVERNMENT NEEDS TO PUT INTO EFFECT NOW THE PRICE ACTIONS ON ELECTRICITY AND GAS, WHICH WERE SUSPENDED IN MARCH. GIVEN THE FACT THAT ELECTRICITY PRICES ARE PROBABLY NOT AS POLITICALLY SENSITIVE AS THOSE OF SOME OTHER PRODUCTS AND SERVICES, WE BELIEVE THAT THE ENTIRE PROJECTED INCREASE OF 400 PERCENT CAN BE MADE EFFECTIVE NOW. EDC IS ALREADY PAYING MUCH HIGHER PRICES FOR FUEL AND IF GOVERNMENT SUBSIDIES ARE TO BE ELIMINATED, THE PROBLEM OF ELECTRICITY PRICES OUGHT TO BE TACKLED PROMPTLY AND DECISIVELY AT ONCE RATHER THAN ALLOWING THE MATTER TO BE DEALT WITH IN TWO STAGES.

WITH RESPECT TO PETROLEUM, THE PUBLIC IS ALREADY ACCUSTOMED, AS A RESULT OF SHORTAGES AND WIDESPREAD UNOFFICIAL SALES OF GASOLINE, TO PAYING HIGHER PRICES. THUS THE TIME IS RIGHT FOR OVERHAULING THE PRICING STRUCTURE TO PERMIT THE DISTRIBUTORS TO FIX SALES PRICES THEMSELVES WITH THE GOVERNMENT COLLECTING A FIXED OR FIXED PERCENTAGE TAX ON THE PRODUCT. AT A MINIMUM, PRICES SHOULD BE INCREASED TO COMPENSATE FOR THE INCREASE IN THE EXCHANGE RATE FROM 200 AT THE TIME THE PRESENT PRICE STRUCTURE WAS ADOPTED IN FEBRUARY TO 230 NOW. EVEN IF THE MODALITIES OF PETROLEUM PRICING ARE NOT REFORMED AT LEAST THE (I) USE OF PER-EQUATION TAXES SHOULD BE ABOLISHED SO THAT ONE PRODUCT DOES NOT SUBSIDIZE ANOTHER; AND (II) PROVISION SHOULD BE MADE TO PERMIT AUTOMATIC ADJUSTMENT IN PRICES TO REFLECT HIGHER LANDED PETROLEUM COSTS AND CHANGING EXCHANGE RATES.

THE PROPOSALS OF THE MINISTRY OF COMMERCE FOR CHANGES IN RICE PRICES APPEAR REASONABLE BUT YOU MAY WISH TO REVIEW THE PROPOSALS TO DETERMINE WHETHER THEY MEET THE IMMEDIATE NEEDS OF THE SITUATION NOW CONFRONTING YOUR COUNTRY. PRICES OF PADDY AND RICE, BOTH AT WHOLESALE AND RETAIL LEVELS, HAVE BECOME VERY SENSITIVE TO THE EFFECTS OF DIMINISHED PLANTINGS AND INTER-
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DICTION OF LINES OF COMMUNICATION. IN THIS DYNAMIC SITUATION IT IS UNREALISTIC FOR THE GOVERNMENT TO ATTEMPT TO FIX THESE PRICES. AS A MINIMUM, THE GOVERNMENT SHOULD NOT REGULATE PADDY AND THE RICE PRICE PURCHASING POLICIES OF SORAPA AND OFFINACO. THEY SHOULD BE FREE TO BUY AT MARKET PRICES. SIMILARLY, YOU OUGHT TO CONSIDER ALLOWING THE RETAIL PRICES FOR RICE IN PHNOM PENH TO FLOAT

IN THE CASE OF ALL QUALITIES OF LOCALLY PRODUCED RICE. SUCH AN APPROACH SHOULD DISCOURAGE SALES OF RICE TO THE ENEMY AND MAKE HIS RICE PROBLEM EVEN MORE UNMANAGEABLE THAN IT PROBABLY IS NOW. WE RECOGNIZE PRICES OF IMPORTED RICE HAVE TO BE SUBSIDIZED, FOR OTHERWISE THEY WOULD BE HIGHER THAN THOSE OF LOCALLY PRODUCED RICE.

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INFO OCT-01 ADP-00 AID-20 EB-11 NSC-10 RSC-01 CIEP-02

TRSE-00 SS-15 STR-08 OMB-01 CEA-02 CIAE-00 COME-00

FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06 SIL-01

INT-08 AGR-20 L-03 SCEM-02 DODE-00 RSR-01 /157 W

----- 041679

R 090420 Z JUN 73

FM AMEMBASSY PHNOM PENH

TO SECSTATE WASHDC 1615

C O N F I D E N T I A L SECTION 2 OF 2 PHNOM PENH 5682

RICE PRESENTS THE MOST SERIOUS SUPPLY PROBLEM YOU NOW FACE. IN ORDER

TO MAXIMIZE THE SUPPLY OF DOMESTIC RICE, BOTH RICE WHICH HAS ALREADY BEEN HARVESTED AS WELL AS THAT FOR THE NEXT CROP, IMMEDIATE AND ENERGETIC STEPS ARE IN ORDER. THE GOAL MUST CONTINUE TO BE TO ACHIEVE SELF-SUFFICIENCY IN RICE, THEREBY ELIMINATING THE PRESENT UNDESIRABLE RELIANCE ON IMPORTED RICE. NOT ONLY WILL PRICE ACTIONS HELP, BUT OTHER MEASURES ARE REQUIRED. IF THE MAXIMUM AMOUNT OF RICE IS TO BE EXTRACTED FROM DOMESTIC SOURCES, PARTICULARLY BATTAMBANG, THE GOVERNMENT MUST CONTINUE TO GIVE PRIORITY TO KEEPING ROUTE 5 OPEN AND IN OPERATING CONDITION; PROVIDE ADEQUATE MILITARY PROTECTION TO FARMERS AND TRACTOR OPERATORS IN ORDER TO EXPAND THE AREA UNDER CULTIVATION; MOVE PHOSPHATE FERTILIZER AS RAPIDLY AS POSSIBLE FROM PHNOM PENH AND KOMPONG SOM TO BATTAMBANG; AND SECURE IMMEDIATE

CONTROL OVER ALL SURPLUS STOCKS OF RICE IN BATTAMBANG AND ACCELERATE THEIR DELIVERY TO PHNOM PENH. THE GOVERNMENT MUST

ALSO ASSURE EQUITABLE AND AMPLE DISTRIBUTION OF RICE IN GOVERNMENT CONTROLLED AREAS, PARTICULARLY PHNOM PENH. IN ORDER TO BRING ALL OF THESE ACTIONS INTO EFFECT, YOU UNDOUBTEDLY WILL WANT TO CONSIDER GIVING TO ONE MINISTER FULL AUTHORITY AND RESPONSIBILITY FOR ALL ASPECTS OF THE RICE PROBLEM-- PRICES, TANSPORT, FERTILIZER, DISTRIBUTION-- AND DIRECTING THE APPROPRIATE RESPONSE BY FANK CONCERNING THE MILITARY ASPECTS OF THE PROBLEM.

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WE REALIZE THAT IN ORDER FOR THE PUBLIC TO ACCEPT THE PROJECTED RICE MEASURES AND TO AVOID SOCIAL UNREST GROWING OUT OF THE UNFAVORABLE PRICE BEHAVIOR DURING THE FIRST PART OF THIS YEAR, AN ADJUSTMENT WILL HAVE TO BE MADE IN SALARY LEVELS OR COST OF LIVING ALLOWANCES OF ALL GOVERNMENT EMPLOYEES, BOTH MILITARY AND CIVILIAN. AN INCREASE OR COST OF LIVING ADJUSTMENT OF 1,000 RIELS PER MONTH PER EMPLOYEE, WHICH WE UNDERSTAND YOU HAVE UNDER CONSIDERATION, SEEMS REASONABLE.

TO ABSORB THE HEAVIER BIRDEN WHICH THIS ADJUSTMENT WILL IMPOSE, ACTIONS MUST BE TAKEN TO INCREASE REVENUES AND RESTRAIN OTHER EXPENDITURES. WHILE THE COLLECTION OF DOMESTIC TAXES DURING THE FIRST FOUR MONTHS INDICATES THAT THE TARGET FOR 1973 WILL BE REACHED, RECEIPTS OF CUSTOMS DUTIES HAVE REMAINED FAR BELOW THEIR POTENTIAL AND IN ANY CASE THE AMOUNT THEY WERE BUDGETED FOR. RECENT EFFORTS TO SPEED UP THE COLLECTION PROCEDURES HAVE HAD SOME RESULTS IN THAT OUTSTANDING ARREARS ON PETROLEUM PRODUCTS HAVE BEEN COLLECTED IN APRIL. HOWEVER, APART FROM THIS ONE- TIME INCREASE THERE SEEMS TO BE A STRUCTURAL DIFFERENCE BETWEEN POTENTIAL AND ACTUAL RECEIPTS OF CUSTOMS DUTIES. UNDER THE PRESENT CIRCUMSTANCES THE COUNTRY CAN ILL AFFORD TO FOREGO THE FULL POTENTIAL OF THIS SOURCE OF REVENUE AND WE WOULD ADVISE TIMELY MEASURES TO REMEDY THIS SITUATION. IT IS ALSO NECESSARY TO EXERCISE RIGOROUS CONTROL OVER ALL EXPENDITURES, PARTICULARLY THOSE FOR MILITARY PERSONNEL. THE PRICE ACTIONS RECOMMENDED ABOVE SHOULD ALSO BE EFFECTIVE IN CURTAILING OR ELIMINATING SUBSIDIES, WHICH NOW CONSTITUTE SUCH A DRAIN ON TOTAL GOVERNMENT RESOURCES.

THE EXCHANGE RATE MUST BE KEPT FROM BECOMING OVERVALUED. THE PRESENT REGIME WAS INTRODUCED IN OCTOBER 1971 WITH OUR STRONG SUPPORT AND ON THE ASSUMPTION THE RATE WOULD BE PERIODICALLY ADJUSTED. IT BASICALLY HAS NOT BEEN CHANGED SINCE THE END OF FEBRUARY, AND PRESENTLY REPRESENTS AN INCREASE OF 23 PERCENT SINCE THE END OF DECEMBER. IT THUS IS NOW LAGGING BEHIND THE RATE OF INFLATION. WITH THE PROGRESSIVE ELIMINATION OF THE EXCESS ADVANCE DEPOSIT REQUIREMENT AND THE LIFTING OF THE BAN ON THE

IMPORTATION OF VEHICLES AND LUXURY GOODS, IT IS APPROPRIATE THAT CONSIDERATION BE GIVEN TO MOVING THE RATE AGAIN, KEEPING IN MIND THE OBJECTIVE OF HAVING IT ACT AS A POSITIVE FORCE IN RESTRAINING THE GROWTH IN THE MONEY SUPPLY. WITH REGARD TO VEHICLES AND LUXURY GOODS, IF YOU FIND THERE IS A SIGNIFICANT INCREASE

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IN DEMAND FOR FOREIGN EXCHANGE FOR THESE ITEMS DESPITE THE
NEW HIGHER TAXES, YOU MAY WANT TO RETURN TO THE POLICY OF BANNING
THEIR IMPORTATION. THIS CERTAINLY WOULD BE UNDERSTANDABLE FOR
POLITICAL REASONS. IN THE MEANTIME, IN ORDER TO ASSURE FULL
TAX COLLECTION, THE PROPOSAL TO COLLECT TAXES IN ADVANCE ON
THESE ITEMS AND OTHER IMPORTED GOODS MIGHT BE USEFULLY STUDIED
AGAIN.

PHNOM PENH
JUNE 9, 1973
SWANK

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*** Current Handling Restrictions *** n/a

*** Current Classification *** CONFIDENTIAL

Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: n/a
Control Number: n/a
Copy: SINGLE
Draft Date: 09 JUN 1973
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: garlanwa
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1973PHNOM05682
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GDS
Errors: n/a
Film Number: n/a
From: PHNOM PENH
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1973/newtext/t19730620/aaaajbwj.tel
Line Count: 243
Locator: TEXT ON-LINE
Office: ACTION EA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 5
Previous Channel Indicators:
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: garlanwa
Review Comment: n/a
Review Content Flags:
Review Date: 20 NOV 2001
Review Event:
Review Exemptions: n/a
Review History: RELEASED <20-Nov-2001 by shawdg>; APPROVED <14-Dec-2001 by garlanwa>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: <DBA CORRECTED> jms 980209
Subject: CURRENT ECONOMIC PROBLEMS
TAGS: EFIN, CB
To: EA
SECSTATE WASHDC
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005